

## Message Text

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E.O. 11652: NA

TAGS: EFIN, EEC

SUBJECT: EC REVIEW OF ITALIAN ECONOMIC CONDITIONS

REFS: A. EC BRUSSELS 9010

B. EC BRUSSELS 8988

C. EC BRUSSELS 8827

1. SUMMARY: ITALY CONTINUE TO ADHERE TO THE ECONOMIC CONDITIONS WHICH WERE INCLUDED IN THE EC'S MEDIUM-TERM CREDIT. COMMISSION OFFICIALS ARE ENCOURAGED BY THE PROGRESS OF THE GOI ECONOMIC PROGRAM. ITALIANS CONDITIONS, HOWEVER, CONTINUE TO BE PRECARIOUS. END SUMMARY.

2. EC FINANCIAL OFFICIALS HAVE JUST COMPLETED A JOINT REVIEW WITH GOI AUTHORITIES IN ROME OF THE ECONOMIC CONDITIONS SET FORTH IN THE EC \$1.4 BILLION MEDIUM-TERM CREDIT TO ITALY (SEE REFTELS). THE UK SUPPLEMENTED THIS AMOUNT BY A \$478 MILLION SHORT-TERM CREDIT, WHICH IT PLANS TO ROLL OVER EVERY THREE MONTHS. COMMISSION OFFICIALS ARE NOW PREPARING A REPORT FOR THE MONETARY COMMITTEE ON THE RESULTS OF THESE DISCUSSIONS. THEY BRIEFED US ON THEIR CONCLUSIONS.

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3. ADHERENCE TO ECONOMIC CONDITIONS: THE GOI HAS

STAYED WITHIN THE QUARTERLY TARGET FIGURES FOR TOTAL LENDING, CENTRAL GOVERNMENT EXPENDITURES AND THE TREASURY DEFICIT. CURRENT TRENDS INDICATE THAT THE GOI SHOULD BE ABLE TO ATTAIN ALL OF THE YEAR-END TARGETS. GOI AUTHORITIES, PARTICULARLY THE BANK OF ITALY, REASSURED EC OFFICIALS OF THEIR CONTINUING COMMITMENT TO THE CONDITIONS. THE GOI, HOWEVER, MAY HAVE DIFFICULTY IN MEETING THE GOVERNMENT EXPENDITURE CEILING BECAUSE THE ECONOMIC RECESSION HAS INCREASED WELFARE PAYMENTS. THIS CEILING WAS BASED ON A PROJECTED 1.5 PERCENT GNP DECLINE IN 1975 BUT GOI AUTHORITIES HAVE NOW REVISED THE DECLINE TO 2.5 PERCENT. EC OFFICIALS DO NOT WANT TO MODIFY THE EXISTING CEILINGS. THEY REPORTEDLY TOLD GOI OFFICIALS TO ABIDE BY THE AGREED-UPON CONDITIONS FOR THE PRESENT TIME.

4. DESPITE RECENT GOI DECISIONS TO INCREASE SELECTED EXPENDITURES, INCREASED TAX REVENUE SHOULD ENABLE THE GOI TO MEET ITS BUDGET DEFICIT CEILING. COMMISSION OFFICIALS EXPRESSED SOME CONCERN OVER THEIR ABILITY TO MONITOR THIS ITEM. THEY FEEL, HOWEVER, THAT GOI TREASURY OFFICIALS ARE BEING FRANK WITH THEM. THE SLACK IN THE ECONOMY HAS SLOWED DEMAND FOR GOVERNMENTAL CREDIT, PARTICULARLY IN THE INVESTMENT AREA. CONSEQUENTLY, THE GOI SHOULD HAVE NO DIFFICULTY IN MEETING ITS CREDIT CEILING.

5. ECONOMIC OUTLOOK: COMMISSION OFFICIALS BELIEVE ITALY'S ECONOMIC OUTLOOK HAS IMPROVED BUT THE SITUATION CONTINUES TO BE PRECARIOUS. THEY ESTIMATE THAT PRICE INFLATION WILL SLOW TO AN ANNUAL RATE OF 13-14 PERCENT BY YEAR END. THE CURRENT ACCOUNT DEFICIT IS LIKELY TO FALL TO ABOUT \$3-4 BILLION THIS YEAR COMPARED TO ABOUT \$8 BILLION LAST YEAR. ITALY SHOULD HAVE NO TROUBLE FINANCING THIS DEFICIT. IT MAY BORROW FROM THE EC COMMON BORROWING FACILITY IF THE TERMS ARE FAVORABLE. THERE ARE INDICATIONS THAT THE ECONOMIC DOWNTURN HAS BOTTOMED OUT AND PRODUCTION SHOULD PICK UP DURING THE SECOND HALF OF THIS YEAR. THE EXPECTED UPSWING, HOWEVER, LIMITED OFFICIAL USE

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COULD REVERSE THE FAVORABLE BALANCE OF PAYMENTS TREND BECAUSE OF INCREASED DEMAND FOR IMPORTS. THE COMMISSION IS CAUTIONING THE GOI TO MODERATE REFLATIONARY PRESSURES SO AS TO PREVENT A DETERIORATION IN ITS BALANCE OF PAYMENTS IN 1976.

6. OFFICIAL FIGURES INDICATE THAT UNEMPLOYMENT NOW AMOUNTS TO ABOUT 3.8 PERCENT. MUCH UNEMPLOYMENT IS

DISGUISED, HOWEVER; COMMISSION OFFICIALS ESTIMATE THE ACTUAL FIGURE SHOULD BE 4.5-5 PERCENT. THE RECESSION HAS HAD AN IMPACT ON ITALIAN LABOR SIMILAR TO THE ONE IN FRANCE -- HARDTIMES HAVE CAUSED LABOR TO BE MORE CONCILIATORY THAN EXPECTED. NEVERTHELESS, COMMISSION OFFICIALS BELIEVE CONTINUED POLITICAL STABILITY IS CENTRAL TO THE GOI'S STABILIZATION PROGRAM. ANY DISRUPTION IS PRESENT ECONOMIC POLICIES WOULD QUICKLY REVERSE CURRENT TREANDS. ITALY NEEDS AT LEAST THIS YEAR TO CONSOLIDATE ITS ECONOMIC GAINS. FOR THIS REASON, THEY BELIEVE THE SITUATION CONTINUES TO BE FRAGILE.

7. THE EC PLANS TO MONITOR ITALY'S ECONOMIC PROGRAM FOR THE FOUR-YEAR PERIOD OF THE MEDIUM-TERM CREDIT. JOINT EC-GOI PROGRAM REVIEWS WILL BE CONDUCTED ON A REGULAR BASIS. GUIDELINES WILL BE DRAWN UP IN NOVEMBER FOR NEXT YEAR'S PROGRAM. THE COMMISSION HAS ASKED THE GOI TO PROPOSE MEASURS TO RATIONALIZE THE PUBLIC SECTOR. THESE MEASURES WILL BE INCLUDED IN NEXT YEAR'S GUIDELINES. THE AIM IS TO ELIMINATE THE GOVERNMENTAL DEFICIT OVER THE NEXT FIVE YEARS AND TO REDUCE MONETARY FINANCING OF TREASURY EXPENDITURES. MYERSON

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